UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, and INSTITUTE OF INTERNATIONAL BANKERS, Plaintiffs, v. UNITED STATES COMMODITY FUTURES TRADING COMMISSION, Defendant.	No. 13-cv-1916 (ESH)

BRIEF OF CURRENT AND FORMER MEMBERS OF CONGRESS AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANT COMMODITY FUTURES TRADING COMMISSION

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INTEREST OF AMICI CURIAE

The *amici* are current as well as former members of Congress who served in 2009 and 2010, during legislative deliberations on the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203 (2010). They are Representatives Barney Frank and current Senators Tom Harkin, Dianne Feinstein, Carl Levin, Jack Reed, and Sherrod Brown, and current and former Representatives Michael E. Capuano, John Conyers, Elijah Cummings, Rosa DeLauro Keith Ellison, Alan Grayson, Stephen F. Lynch, Carolyn Maloney, George Miller, R. Bradley Miller, Charles Rangel, Niki Tsongas, and Maxine Waters. Additional information on the *amici* and their relevant committee service is listed in an appendix to this brief.

The *amici* have an interest in the proper interpretation and enforcement of the Dodd-Frank Act to promote the stability and integrity of the financial system in the United States, prevent economic turmoil and hardship from future financial crises, and protect taxpayers from future bailouts. The *amici* oppose the relief sought by the plaintiffs in this action, which would allow swaps-market participants to evade United States regulation of almost the entire global swaps market by the expedients of trading swaps through foreign subsidiaries or booking swaps on foreign trading desks or exchanges.

ARGUMENT

I. Congress intended that swaps regulations have cross-border effect under section 2(i) without further action by the CFTC.

The plaintiffs now resume a battle that they fought and lost before Congress. Congress specifically considered the arguments that the plaintiffs make in this action against the extraterritorial application of swaps regulation, and was not persuaded.

Edward J. Rosen testified before the House Agriculture Committee on February 4, 2009, on behalf of the plaintiff SIFMA. "Recognizing that our markets are global and inextricably linked," Rosen said:

> [I]nternational coordination and harmonization are important objectives. However, these objectives can be better accomplished without the prescriptive imposition of U.S. rules on foreign markets. In addition to potentially curtailing U.S. access to foreign markets, any such approach would likely be regarded as imperious and may well invite retaliatory measures that could compromise the ability of U.S. exchanges to compete for international business—currently an important growth segment of U.S. exchange markets.

Hearing to Review Derivatives Legislation Before the H. Comm. on Agriculture, 111th Cong. 240 (2009) (statement of Edward J. Rosen, on behalf of Securities Industry and Financial Markets Association).

Gary Gensler, Chairman of the CFTC, told the House Financial Services Committee on October 7, 2009, that:

> I am concerned that the [proposed legislation] could allow foreign financial institutions to be exempted from our requirements. We must ensure that we do not inadvertently create gaps in our regulatory system through exemptions for foreign regulations… Market participants should only be exempt from American regulation through compliance with foreign standards where there has been a determination by U.S. regulators that the foreign scheme is comprehensive and comparable to our standards.

Reform of the Over-the-Counter Derivative Market: Limiting Risk and Ensuring Fairness, Hearing Before the H. Comm. on Fin. Serv., 111th Cong. 116-17 (2009) (prepared statement of the Hon. Gary Gensler, Chairman, Commodity Futures Trading Commission).

Congress heard both arguments, and was persuaded by Chairman Gensler's.

The House Financial Services Committee considered the legislation on October 14, 2009. Representative Spencer Bachus, the ranking Republican on the Committee, offered an amendment that provided:

> **Extraterritorial Limitation.**—No provision of this Act that would otherwise apply to transactions in swaps…or any rule or regulation prescribed by the [CFTC] thereunder shall apply to a swap between non-resident persons transacted without the use of the mails or any other means or instrumentality of interstate commerce.

H. Comm. on Fin. Serv., 111th Cong., Markup of H.R. 3795 (October 14, 2009), Amdt. 21 as offered, http://financialservices.house.gov/media/file/markups/111/bachus_001_xml.pdf .

"My amendment would not extend the bill for [swaps] beyond the U.S. based over-the-counter derivatives market," Representative Bachus said. "The amendment would limit the legislation's application to non-U.S. residents who conduct swap transactions with other non-U.S. residents." Webcast of H. Comm. on Fin. Serv., 111th Cong., Marku p of H.R. 3795 (October 14, 2009), http://archives.financialservices.house.gov/Hearings/hearingDetails .aspx?NewsID=801 (Remarks of Rep. Bachus at 3:29:56—3:30:12).

Representative Barney Frank, the Chairman of the Committee, said: "I would be opposed to a blanket exemption. There may well be cases where non-U.S. residents are engaging in transactions that have an effect on us and we would find them insufficiently regulated internationally and I would not want to prohibit our regulators from stepping in, so I would oppose the amendment." *Id.* (Remarks of Rep. Frank at 3:31:01—3:31:19). Representative Frank said U.S. regulators should cooperate with "foreign countries that have good [regulatory] regimes," but ensure that "none of us are vulnerable to the people who decide to be an escape hatch." *Id.* (Remarks of Rep. Frank. at 3:32:56—3:33:07). Representative Bachus withdrew the amendment, and Representatives Bachus and Frank agreed to continue to work on the issue.

When the House considered the legislation on December 10, 2009, Representative Collin Peterson, Chairman of the House Agriculture Committee, offered an amendment to many provisions of the swaps legislation to which the leaders of the Agriculture and Financial Services Committees had agreed. 155 Cong. Rec. H14682 (daily ed. Dec. 10, 2009) (statement of Rep.

Peterson). The House approved the amendment by voice vote. *Id.* at H14709. The amendment included the language that is now section 2(i) of the Commodities Exchange Act, 7 U.S.C. § 2(i). *Id.* at H14685 (amendment no. 3 offered by Rep. Peterson). The provision was enacted into law without specific discussion in the brief debate of the amendment on the House floor or in later deliberations on the legislation.

In *Immigration & Naturalization Service v. Cardoza-Fonseca*, 480 U.S. 421 (1987), the Senate version of legislation restricted the discretion of the Attorney General to grant asylum to refugees and imposed additional requirements for asylum. Congress enacted a more forgiving House version. "The enactment of the House bill rather than the Senate bill . . . demonstrates that Congress eventually refused to restrict eligibility for asylum only to aliens meeting the stricter standard," the Court said. "Few principles of statutory construction are more compelling than the proposition that Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded in favor of other language." *Id.* at 442-43 (citation omitted). *See also*, *e.g.*, *Pacific Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 220 (1983); *Doe v. Chao*, 540 U.S. 614, 622 (2004).

In effect, the plaintiffs now seek to amend the enacted legislation to replace section 2(i) with the Bachus amendment. Congress discarded that amendment in favor of the language in section 2(i). Section 2(i) cannot now be interpreted to mean the same as the discarded Bachus amendment. Congress intended in section 2(i) to create a justiciable standard to govern the extraterritorial effect of swaps regulations without further action by the CFTC, and did.

"It emerges clearly that the prescription for legislative action in [the Constitution] represents the Framers' decision that the legislative power of the Federal Government be exercised in accord with a single, finely wrought and exhaustively considered, procedure." *Immigration & Naturalization Service v. Chadha*, 462 U.S. 919, 951 (1983). The repeal or amendment

of enacted legislation requires the same procedure. *Clinton v. City of New York*, 524 U.S. 417, 438 (1998). Congress alone can amend the Dodd-Frank Act to replace section 2(i) with the Bachus Amendment.

II. Absent an express requirement of formal rulemaking and consideration of costs and benefits, the CFTC has the discretion to apply section 2(i) on a case-by-case basis.

The plaintiffs also resume a battle that they fought and lost before the CFTC. The plaintiffs urged the CFTC to adopt a general, prospective rule on the extraterritorial effect of swaps regulation by formal rulemaking, complete with consideration of costs and benefits, a procedure almost as "finely wrought and exhaustively considered" as legislation.

The CFTC decided against "rigidifying its tentative judgment into a hard and fast rule" based upon abstract assumptions. *See Sec. & Exch. Comm'n v. Chenery Corp.*, 332 U.S. 194, 202 (1947) ("*Chenery II*"). Instead, the CFTC decided to use a "facts and circumstances" test, applying section 2(i) to concrete facts and allowing "a case-by-case evolution of statutory standards." *Id.* at 203. That decision was well within the CFTC's discretion. CFTC published the guidance to advise market participants how the CFTC expects to apply section 2(i) in certain circumstances that are likely to arise. The CFTC did not intend by that help to market participants to create legally binding rules, especially in unanticipated circumstances. *See* Def's Mem. at 23-24.

Congress did not require formal rulemaking or consideration of costs and benefits by the CFTC before section 2(i) can take effect. "If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation." *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984). The Dodd-Frank Act requires the CFTC and other agencies to adopt many rules by formal rulemaking before specific provisions of the legislation will be effective. Congress did not require such a rule on the extraterritorial effect of swaps regulation. There is neither an explicit

gap for the CFTC to fill nor any express delegation of rulemaking authority on the extraterritorial effect of swaps regulation.

In *Central Bank of Denver, N.A. v. Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the statute did not expressly create aiding and abetting liability in private claims for securities fraud, but the plaintiff argued that statutory language "hinted" at such liability. The Court was unpersuaded. "Congress knew how to impose aiding and abetting liability when it chose to do so," the Court said. "If … Congress intended to impose aiding and abetting liability, . . . it would have used the words 'aid' and 'abet' in the statutory text. But it did not." *Id.* at 176-77 (citations omitted).

Congress knew how to impose a requirement of formal rulemaking and consideration of costs and benefits. Congress did so many times in the Dodd-Frank Act, and specifically in Title VII. Congress chose not to do so with respect to the cross-border effect of swaps regulation.

That is not to say that the CFTC will need to do no interpretation of section 2(i). Neither Congress nor the CFTC can possibly anticipate "many of the specialized problems which arise" in applying statutory standards. "Not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular unforeseeable situations." *Chenery II*, 332 U.S. at 202.

A "facts and circumstances" test and "case-by-case evolution" of the statutory standard is especially suited for an agile industry gifted at "innovation" to defeat lumbering "hard and fast rules." If the CFTC can address new practices only by prospective, formal rulemaking, the agency will always be months or years behind industry practices.

III. An exception for cross-border swaps would be a loophole through which almost the entire global swaps market could fit.

Swaps regulation cannot be remotely effective with a hard and fast "territorial scope." Any hard and fast exception to cross-border application of swaps regulation would immediately swallow the rule.

The swaps market is truly global, and the traditional connections between swaps, swaps counterparties, and any given jurisdiction can be easily manipulated and often mean little. The "interpretative guidance and policy statement" voluntarily published by the CFTC suggests a prudential weighing of "principles of international comity," none of which is determinative. The guidance is entirely consistent with the language and legislative history of section 2(i). Some swaps have important links to a specific jurisdiction, so that the jurisdiction has a legitimate interest in regulating the swap and the counterparties to the swap have a legitimate expectation that the jurisdiction's law will govern, but many other swaps do not have such links to a specific jurisdiction.

First, the jurisdiction of the incorporation of a swap counterparty is easily manipulated. According to a 2012 study by the Federal Reserve Bank of New York, JPMorgan Chase had a total of 3,391 subsidiaries, of which 451 were foreign. Goldman Sachs had 3,115 subsidiaries, of which 1,670 were foreign. Morgan Stanley had 2,884 subsidiaries, of which 1,289 were foreign. In all, the largest American bank holding companies had almost 20,000 subsidiaries. Each of the seven largest bank holding companies had subsidiaries in at least 40 countries. D. Avraham, P. Selvaggi and J. Vickery, *A Structural View of U.S. Bank Holding Companies*, FRBNY Economic Policy Review, at 71 (July 2012).

These global financial institutions "operate as a single enterprise, typically with consolidated management, an integrated technology base, and—most significantly—a common

capital and liquidity pool." H. Miller and M. Horwitz, *A Better Solution Is Needed for Failed Financial Giants,* The New York Times, (October 9, 2012). "Despite their corporate complexity, [large complex financial institutions] tend to be managed in an integrated fashion along lines of business with only minimal regard for legal entities, national borders or functional regulatory authorities." R. Herring and J. Carmassi, *The Structure of International Financial Conglomerates: Complexity and Its Implications for Systemic Risk*, Oxford Handbook of Banking (2009).

Swaps by nominal foreign subsidiaries of U.S. financial institutions pose enormous risk to the U.S. financial system. According to the Office of the Comptroller of the Currency, in the third quarter of 2013, insured U.S. commercial banks and savings associations had derivatives with $240 trillion in notional value, 63 percent of which was swaps, all heavily concentrated in systemically important institutions. JPMorgan Chase and Citibank each had swaps of $40 trillion in notional value. Goldman Sachs had swaps of $35 trillion in notional value. Bank of America had swaps of $26 trillion in notional value. *OCC's Quarterly Report on Bank Trading and Derivatives Activities, Third Quarter 2013*. According to a Bloomberg News analysis, U.S. banks transact much of their swaps business through foreign subsidiaries. S. Brush, *Goldman Sachs Among Banks Fighting To Exempt Half of Swaps Books,* Bloomberg News (January 30, 2012).

"Among Lehman Brothers' complex web of affiliates was Lehman Brothers International (Europe) in London," CFTC Chairman Gary Gensler said. "When Lehman failed, this London affiliate, with more than 130,000 outstanding swaps contracts, failed as well. Who stood behind these swaps contracts? The U.S. mother ship, Lehman Brothers Holdings, had guaranteed many of them." G. Gensler, *Remarks on Derivatives and the Cross-Border Application of Dodd-Frank Swap Market Reforms at the Institute of International Bankers' Membership Luncheon,* (June 14, 2012). Many swaps for Citigroup and Bear Stearns, Gensler said, were through affiliates incorporated in the Cayman Islands, a jurisdiction notorious for lax regulation.

Second, the jurisdiction in which a swap is "booked" is also easily manipulated:

> The OTC segment operates with almost complete disregard of national borders. Derivatives exchanges themselves provide equal access to customers worldwide. As long as local market regulation does not impose barriers, participants can connect and trade remotely and seamlessly from around the world (e.g. from their London trading desk to the Eurex exchange in Frankfurt)….From a user perspective, the location of an OTC trading desk or a derivatives exchange is usually irrelevant.

The Global Derivative Market: An Introduction, Deutsche Bőrse Group, 12-13 (April 2008).

The "London Whale" trades demonstrate the yawning loophole that the plaintiffs would have the Court create. The CFTC ordered JPMorgan to pay a $100 million civil penalty for manipulative conduct in connection with the trades "because [JPMorgan traders] sold enormous volumes of [the swaps] in a very short time" to interfere with legitimate forces of supply and demand to influence prices. Order Instituting Proceedings Pursuant To Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions at 14, CFTC Docket No. 14-01 (2013). The trades were by a JPMorgan subsidiary that was incorporated in Delaware, but could have been incorporated in the Cayman Islands. The subsidiary's offices were in London, but could have been in New York. The trades were booked in London, but could have been booked in Frankfurt. The trades were in JPMorgan's "synthetic credit portfolio," a "basket" of credit default swaps on debt that JPMorgan did not hold. JPMorgan's $6.2 billion in losses on the trades were included on the bank's consolidated balance sheet in the United States, and the manipulative conduct affected the integrity of the swaps market worldwide, including the United States. Without doubt, the trades had a "direct and significant connection with activities in, or effect on, commerce of the United States." 7 U.S.C. § 2(i)(1). JPMorgan could easily have altered, however, every formal connection of the swaps to any given jurisdiction to fit within any exception in a hard and fast rule on the cross-border effect of swaps regulation.

In short, the relief sought by plaintiffs would allow almost the entire global swaps market to evade United States regulation by the simple expedients of trading through a foreign subsidiary or booking the swap on a trading desk or a derivatives exchange located in another nation, regardless of how insignificant those connections to any other jurisdiction, how significant the effect on the U.S. financial system and economy, or how flimsy the regulatory standards of the jurisdiction to which the swap would be subject.

That is not the law that Congress enacted. For good reason, Congress decided not to enact a "blanket exemption" from regulation of extraterritorial swaps, and the CFTC decided to proceed by the case-by-case application of section 2(i) to concrete facts and thus prevent the evasion of the law by industry "innovation." The Court should respect the intent of Congress not to exclude extraterritorial swaps from regulation, and the discretion of the CFTC not to adopt a "hard and fast" rule.

CONCLUSION

The Court should deny the plaintiffs' motion for summary judgment and grant the CFTC's consolidated motion to dismiss and cross-motion for summary judgment.

Date: March 21, 2014

Respectfully submitted,

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APPENDIX OF AMICI CURIAE

Representative **Barney Frank**, Chair, House Committee on Financial Services, 111th Congress. Co-sponsor of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Senator **Tom Harkin**, Chair, Senate Committee on Health, Education, Labor and Pensions. Member of the Senate Committee on Agriculture, Nutrition, and Forestry, 111th Congress.

Senator **Dianne Feinstein**, Chair, Senate Committee on Intelligence.

Senator **Carl Levin**, Chair, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs.

Senator **Jack Reed**, Chair, Subcommittee on Securities, Insurance, and Investments of the Senate Committee on Banking, Housing, and Urban Affairs, 111th Congress.

Senator **Sherrod Brown**, Chair, Subcommittee on Financial Institutions and Consumer Protection of the Senate Committee on Banking, Housing, and Urban Affairs. Member of the Senate Committee on Banking, Housing, and Urban Affairs, 111th Congress.

Representative **Michael E. Capuano**, Member of the House Committee on Financial Services, 111th Congress.

Representative **John Conyers**, Ranking Member, House Committee on the Judiciary.

Representative **Elijah Cummings**

Representative **Rosa DeLauro**

Representative **Keith Ellison**, Member of the House Committee on Financial Services, 111th Congress.

Representative **Alan Grayson**, Member of the House Committee on Financial Services, 111th Congress.

Representative **Stephen F. Lynch**, Member of the House Committee on Financial Services, 111th Congress.

Representative **Carolyn Maloney**, Ranking Member, Subcommittee on Capital Markets of the House Committee on Financial Services. Member of the House Committee on Financial Services, 111th Congress.

Representative **George Miller**, Ranking Member, House Committee on Education and the Workforce.

Representative **R. Bradley Miller**, Member of the House Committee on Financial Services, 111th Congress.

Representative **Charles Rangel**

Representative **Niki Tsongas**

Representative **Maxine Waters**, Ranking Member, House Committee on Financial Services. Member of the House Committee on Financial Services, 111th Congress.